United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-5044

United States Court of Appeals

For The Second Circuit

In re

INTERSTATE STORES, INC., *et al.*,

Debtors,

CALIFORNIA WHOLESALE ELECTRIC COMPANY,
formerly known as Esgro, Inc.,

Appellant,

against

JOSEPH R. CROWLEY and HERBERT B. SIEGEL, as Reorganization Trustees for Interstate Stores, Inc., *et al.*, Debtors,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF APPELLEES

SHEA GOULD CLIMENKO & CASEY
Attorneys for Appellees
330 Madison Avenue
New York, New York 10017
(212) 661-3200

MARTIN I. SHELTON,
DANIEL L. CARROLL,
Of Counsel.

TABLE OF CONTENTS

TABLE OF CONTENTS - continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES - continued

Issues Presented

1. Should appellant, having prevailed in its attempt to have the merits of its claim against debtor tried by a jury in the California Superior Court rather than in the Bankruptcy Court and having been denied, prior to the commencement of said trial, leave by the California Court to file an amended pleading which was substantially identical to the amended proof of claim dismissed by the order from which this appeal is taken, now be permitted to file an amended proof of claim in the Bankruptcy Court after a judgment has been entered in the California Court dismissing its claim on the merits.

2. Did the order of the United States District Court for the Southern District of New York ("District Court"), dated November 17, 1976 and entered on November 24, 1976, violate the order of this Court dated November 23, 1976 and entered in the Bankruptcy Court on November 26, 1976.

3. Did the District Court properly strike and dismiss the amended proof of claim filed by appellant.

Statement of the Case

Introduction

In its statement of the case and the facts, appellant California Wholesale Electric Company, formerly known as Esgro, Inc. ("Esgro"), presents at best an incomplete picture of what has transpired in this matter since it was last heard by this Court. For example, Esgro's brief is completely silent with respect to:

(a) the entry of a judgment in the California Superior Court dismissing Esgro's claims in their entirety and awarding debtors a total of $1,350,558.51, plus attorneys' fees and costs, following this Court's November 23, 1976 order which directed the parties to proceed to trial in the matter then pending in the Superior Court of the State of California (the "California Proceeding");

(b) the ruling by the California Court prior to the trial of the California Proceeding, which denied Esgro's motion for leave to file an amended pleading which was substantially identical to the amended proof of claim filed by Esgro in this reorganization proceeding and which was dismissed by the District Court in the order appealed from.*

* Permission was obtained by appellees from the District Court to file certain papers from the California Proceeding. These papers are now included in the Supplemental Appendix to this brief. For obvious reasons, Esgro opposed the Trustees' application to the District Court in connection with the filing of these papers.

Factual Background To Dispute

Certain of the debtors involved in this reorganization proceeding operated a group of discount department stores in California, Oregon and Washington known as White Front Discount Department Stores. Esgro was a concessionaire or licensee in these stores, operating cameras and jewelry and liquor departments in said stores from the early 1960's.

In December 1970, Esgro and White Front entered into a further agreement providing for the operation of an additional department, known as a Residential Interior Department, in the White Front stores and eventually opened such a department in thirty-three stores. In late 1972, White Front announced the closing of a number of White Front stores, whereupon Esgro closed its Residential Interior Departments in all of the stores. Subsequently, in mid-1974, after the commencement of this reorganization proceeding, the Trustees closed the remaining White Front stores.

The Commencement of the California Proceeding

In February of 1973, the White Front debtors commenced an action against Esgro in the California Superior Court seeking to recover a total of $879,121.52 for rent

and other miscellaneous amounts due from Esgro in connection with its operation of the Residential Interior Departments (JA 20*). In July of 1973, Esgro filed a cross-claim in the California Proceeding, seeking to recover $35,000,000, alleging fraud, breach of contract and interference with contract (JA 21, SA 22-31**). The California proceeding remained essentially dormant until June of 1976.

Esgro's Claim And Proceedings
In Connection Therewith In
The Bankruptcy Proceedings

In August of 1974, Esgro filed Claim 7273A with appellees (A 58-64***). This claim, for a total of $38,758,972, asserted essentially the same allegations of wrongdoing as those contained in Esgro's cross-complaint in the California Proceeding (SA 22). On April 9, 1976, the Trustees filed an application with the Bankruptcy Court to expunge that claim. Said application set into motion a number of procedural steps by both sides, Esgro seeking to obtain a trial in the California State Court and the Trustees seeking to have the claim adjudicated in the Bankruptcy Court. The end result was this

* References preceded by "JA" refer to the Joint Appendix filed in the prior appeal in this matter entitled Sulmeyer v. Crowley, et al., Docket No. 76-5034.

** References preceded by "SA" are to the Supplemental Appendix filed herein.

*** References preceded by "A" refer to the Joint Appendix herein.

Court's November 23, 1976 order which directed the parties to proceed to trial in the California Superior Court on November 29, 1976 (A 172).

The Filing By Esgro Of
The Amended Proof of Claim

This Court's November 23, 1976 order also stayed Judge Cannella's September 1, 1976 order (JA 503-506) to the extent that it had directed that the Trustees' objection to Esgro's claim be tried in the Bankruptcy Court. Thus, prior to the entry of the November 23, 1976 order, the parties had been proceeding for almost three months on the assumption that the action would proceed to trial in the Bankruptcy Court. Discovery had been completed and a pretrial order had been prepared and filed. At a conference held before Judge Cannella on October 18, 1976, Judge Cannella directed the Trustees to file a "counterclaim" against Esgro so that all of the issues relating to Esgro's operation of the Residential Interior Departments could be tried at one time. The Trustees complied by filing a complaint in an adversary proceeding on October 22, 1976 (A 10-20). This complaint sought to recover from Esgro the amounts sought in the complaint in the California Proceeding plus additional amounts that had become due after the commencement of the California Proceeding (A 19-20).

At the October 18, 1976 pretrial conference, Esgro's counsel, in response to Judge Cannella's direction to the Trustees, inquired as to whether Esgro would be permitted to amend its pleadings. Counsel for the Trustees objected and it was left that any ruling in this regard would be left to the judge who ultimately tried the case (A 54, A 156).*

On November 1, 1976, Esgro filed an amended proof of claim (which was dated October 21, 1976) (A 21-29, A 50). The Trustees immediately moved to dismiss the amended proof of claim upon the ground that it had not been timely filed and upon the ground that it would be extremely prejudicial to the Trustees if it were permitted (A 47-48). Essentially, the Trustees took the position that they had had no opportunity to conduct discovery on the new claim set forth in the amended proof of claim and did not have a chance to prepare a defense to those claims in that trial in the District Court was set for mid-November (A 51, A 54-55). Indeed, it is clear from the record before this Court that Esgro had deliberately concealed its intention to assert these new claims until <u>after</u> the Trustees had completed crucial depositions and had waited approximately four months before attempting to formally assert these claims in either the Bankruptcy Court or the California Proceeding (A 52-55).

* Judge Cannella indicated at the October 18 conference that the matter would, in all probability, be assigned to another District Court judge for trial.

Judge Gagliardi's Dismissal
Of The Amended Proof of Claim

On November 16, 1976, the parties appeared before District Judge Gagliardi, to whom the case had been assigned for trial, for the purpose of attending to some pretrial matters (A 178). This was also the adjourned return date of the Trustees' motion to dismiss the amended proof of claim. At the conference, Judge Gagliardi stated that he would grant the Trustees' motion (A 191-192) and his decision, dated November 17, 1976, was endorsed on the Trustees' motion papers (A 184). This order was not entered by the clerk until November 24, 1976 (A 184). Meanwhile, the parties had been informed by this Court that Judge Gagliardi had been asked to adjourn the trial date (A 188-189) and on November 23, 1976, the Court of Appeals rendered a decision on Esgro's motion for a stay* directing the parties to proceed to trial in California (A 186). This order was entered in the Bankruptcy Court on November 26, 1976 (A 2).

* No decision has been rendered by this Court on the prior appeal which was Esgro's appeal from Judge Cannella's September 1, 1976 order.

Esgro's Attempt to Amend
Its Cross-Complaint In
The California Proceeding

On November 29, 1976, Esgro made a motion to the California Court for leave to file an amended cross-complaint, which was substantially identical to the amended proof of claim which had been dismissed by Judge Gagliardi on November 17, 1976 (SA 32). The Honorable Max Deutz, the California Superior Court judge to whom the California Proceeding had been assigned for trial, denied Esgro's motion to amend on December 6, 1976, the date the trial of the California Proceeding commenced (SA 45-54). The stated reason for his decision was that the Trustees would be prejudiced if Esgro were permitted to amend its cross-complaint on the eve of trial (SA 48). In addition, Judge Deutz indicated that he felt that the issues to be tried in the California Proceeding were circumscribed by the issues as set forth in Esgro's original proof of claim filed in the reorganization proceeding (SA 46). However, Judge Deutz was aware of the fact that Esgro had, on December 3, 1976, applied to Judge Gagliardi for an order vacating his November 17, 1976 order (A 174) and indicated that Esgro could make a further application depending upon the outcome of the application before Judge Gagliardi (SA 46-47).

On December 9, 1976, Judge Gagliardi, with the consent of the parties, called Judge Deutz and told him in effect that he did not want Judge Deutz to feel constrained by his order dismissing Esgro's amended proof of claim and that he would enter any order Judge Deutz thought appropriate (SA 59). Judge Deutz indicated to Judge Gagliardi that his decision had been made on the basis of California law as well as his consideration of the "jurisdictional problem" and that he felt the matter should be left as it was (SA 59-60). Judge Gagliardi thereupon rendered a decision dated December 15, 1976 explaining the reason for his November 17, 1976 order (A 194-195).

The Trial of the
California Proceeding

On December 6, 1976 a jury was selected and the trial of the California Proceeding commenced. The trial continued for four full weeks and on January 6, 1977 the jury returned a verdict in White Front's favor and against Esgro on its cross-complaint (SA 70). On January 7, 1977, a judgment was entered in the California Proceeding awarding the White Front debtors $1,350,558.51 (plus attorneys' fees and costs) and dismissing Esgro's cross-complaint (SA 68-73).

POINT I

THE DISTRICT COURT'S NOVEMBER 17, 1976 ORDER DISMISSING ESGRO'S AMENDED PROOF OF CLAIM WAS NOT VIOLATIVE OF THIS COURT'S NOVEMBER 23, 1976 STAY ORDER

In Point I of its brief, Esgro argues that Judge Gagliardi's November 17, 1976 order was in "direct contravention" of this Court's November 23, 1976 stay order. It supports its position with the technical argument that Judge Gagliardi's order, although dated November 17, was not physically entered in the Bankruptcy Court's docket until November 24, 1976, the day after this Court rendered its stay order.

This argument ignores two very important facts. First, this Court's November 23 order was not physically entered in the Bankruptcy Court until November 26, 1976, two days after Judge Gagliardi's order was entered. Second, and more important, there is nothing in this Court's November 23, 1976 order which prevented the District Court from making any appropriate order with respect to the amended

proof of claim filed by Esgro.*

Esgro argues (at page 18 of its brief) that this Court, by its November 23, 1976 order, intended that all disputes between the parties should be adjudicated in one forum and that Judge Gagliardi's order somehow interfered with this intent. Again, Esgro completely ignores the fact that all issues in dispute between the parties, including the question of whether amendments to the pleadings should be permitted, were tried and resolved by the California Court. No explanation is provided as to why Esgro's amended

* At a number of places in its brief, Esgro argues that this Court's November 23, 1976 order "stayed all proceedings" in the District Court with respect to the Esgro matter (see, e.g., Esgro Brief, pp. 2, 4). This totally distorts the truth. When Esgro appealed Judge Cannella's September 1, 1976 order, its notice of appeal, and therefore this Court's jurisdiction, was limited to that part of Judge Cannella's order "setting a trial before [the Southern District Court] of the application of defendants-appellants-appellees to expunge the claim of Sulmeyer (Claim No. 7273A), commencing October 18, 1976 at 10:00 a.m." (JA 518). Therefore, this Court's November 23, 1976 stay order, which recited that it was directed to that part of Judge Cannella's order "staying the prosecution and commencement of the trial in the California State Court on November 29, 1976", related only to that part of the September 1, 1976 order which had directed a trial of the Esgro matter before Judge Cannella. No mention whatever is made in the November 23, 1976 order of other matters relating to the Esgro claim, i.e., specifically, as it relates to this appeal, to the District Court's power to dismiss Esgro's proposed Amended Proof of Claim.

proof of claim should now be permitted to stand in light of the California Court's decision not to permit an amendment to the cross-complaint. Indeed, such a result would be directly contrary to Esgro's position that all claims were to be tried in California.*

Esgro does urge (at page 18 of its brief) that the "California court interpreted the District Court's order striking Esgro's amended proof of claim as a restriction on its jurisdiction."** A review of the record before this Court shows that this was not the case and that the California Court's decision was based upon its opinion that under California law the amendment should not be per-

---

* See also, page 5 of its brief where Esgro argues that Judge Gagliardi's order "should be vacated in light of the ... prosecution of the claims and cross-claims between Esgro and the Trustees in the California Court" reasoning that "[i]ssues as to the nature of the claims and cross-claims and damages flowing therefrom should be properly left to the trial court in California". In fact, this is exactly what has happened. The question of whether Esgro should be permitted to amend its cross-complaint was decided--against Esgro--by the California Court and thereafter the California jury decided all issues on the merits of the claims between Esgro and the Trustees--again against Esgro.

** Curiously, in making this argument, Esgro omits to even mention its attempt to amend its cross-complaint in California.

mitted in view of the prejudice that would inure to the Trustees. Thus, although the California Court, in deciding not to permit Esgro to amend, noted that it thought that the "trial in California must be tried within the parameters of the of the claim filed in New York" (SA 46), it went on to say:

> "And then lastly, we come down to the question of whether or not the proceedings in California as proposed under the amended cross-complaint would induce new and entirely different issues into the California proceeding on the eve of trial. The initial allegations in California in the cross-complaint are that there was fraud, there was breach of contract, and there was interference with contract.
>
> "But we are concerned only at this point with the fraud allegation and the fraud allegations in the cross-complaint, original cross-complaint, are that the plaintiffs and cross-defendants failed to disclose to the cross-complainants at the time their contract was entered into in 1970 that they proposed to close down certain of their stores. And the cross-complaint alleges that had the cross-complainants known of this fact, they would not have entered into a contract * * *
>
> "Now it is proposed in the amended cross-complaint that they allege that there was affirmative fraud on the part of the cross-defendants by deliberate misrepresentations as to the financial condition of the White Front Stores, and that the cross-defendants were misled by the deliberate misrepresentations as to financial condition.

"I am of the view, and as argued by counsel for the cross-defendants, that this induces an entirely new cause of action for fraud independent and apart from the cause of action alleged in the original cross-complaint for failure to disclose an intent to close certain of the White Front Stores.

"I realize there is a certain interrelation of evidence between the two sets of allegations of fraud, but, nevertheless, I can't help but feel that the alleged allegation of positive misrepresentations which would then be presented to the jury under the amended cross-complaint would be substantially prejudicial to the cross-defendants" (SA 47-48; emphasis added).

Later in the same hearing, after the Court was informed of the need to obtain a speedy adjudication of the Esgro claim (SA 51) and after counsel for Esgro had offered to make Mr. Esgro available for immediate deposition in an attempt to overcome the Trustees' position that they had been denied discovery on the matters alleged in Esgro's proposed amendment, the Court also noted:

"THE COURT: I think in order to make the record clear, it appears to the court that all Mr. Esgro's deposition would do would be to specify the charges as to the particular statements allegedly made by these other individuals, and then thereafter it would be necessary to locate the other individuals who are no longer in the employ of White Front or Interstate and to take their depositions as to their versions of the conversations.

"So it would be an ongoing proposition that might be very time-consuming" (SA 53).

In responding to a comment by Esgro's counsel that the subjects that would be covered by any such depositions were relevant under the original cross-complaint, the Court reiterated its holding that the proposed amendment should not be permitted under California law since it would raise totally new issues to the prejudice of the cross-defendants:

> "THE COURT: Collaterally, yes, they may be relevant to some of them as to the question of whether or not White Front intended to close those stores at the time they made the contract. But there is the additional element being charged here now of deliberate fraudulent misrepresentations, and that has not been an element of the proceedings up to the present time. That is the thing that concerns the court the most." (SA 54; emphasis added.)

Moreover, a telephone conversation between Judge Gagliardi and Judge Deutz during the course of these proceedings, a summary of which was dictated by Judge Deutz on the record, further underscores the fact that the Court did not base its denial of leave to amend in the California Proceeding on what had transpired in Federal Court. As the Court noted:

> "Judge Gagliardi told me he was calling with the consent of the attorneys representing those parties in New York and that he had had an informal discussion this morning with counsel where they had discussed without a formal hearing the question of an order to show cause why the court should not recall its order striking an amendment to the claim in the New York proceedings.

"He indicated that he had granted the order to strike in the initial instance because he was planning to go to trial with the matter in New York and he thought it was too late a date to have an amendment to the proceeding there and he was satisfied that most of what the cross-complainants here, or the complainants there, were talking about might be covered under the claim as it then existed.

"He wanted to talk to me because he said he did not want to hinder the proceedings here and would be inclined to make an order whichever way I felt that the matter should go here in California.

"I explained to him that I made my ruling on the basis of not only the lateness of the proceeding and the difficulty of going to trial immediately without discovery on the issues of specific misrepresentations that were alleged in the proposed amended cross-complaint, but I was also concerned about this trial here going into issues that were beyond the parameters or beyond the limits of the authority given by the New York court for a civil court here in California to try the matter.

"Judge Gagliardi indicated that he hadn't thought of that problem and he was interested in that aspect of the case. Then I also indicated to him that I was a little concerned that if he enlarged the claim there in New York by permitting the amendment and I did not permit a similar amendment here in California, we might wind up with trying only part of the pending issues and then leaving more issues back in the bankruptcy court that would hold up the closing of the estate back there. And that also interested him very much and he asked me ultimately whether I wanted the matter enlarged by an amendment back there and I said, frankly, the way it stood right now I did not because I felt that it was only going to create more problems for him and for us if we did so.

"So he said he was going to drop it at that point. So that's the story" (SA 59-60).

The above clearly demonstrates that, even if the California Court felt there was a "jurisdictional problem" in connection with Esgro's proposed amendment, this was not the basis for its decision, since Judge Gagliardi offered to remove any "jurisdictional" obstacle the California Court thought might have existed and Judge Deutz decined that offer.

POINT II

ESGRO'S AMENDED PROOF OF CLAIM WAS PROPERLY DISMISSED BY THE DISTRICT COURT

In essence, Esgro is asking this Court to overrule both the District Court as well as the California Superior Court in that both courts, when presented with Esgro's amended pleading, concluded that it should not be permitted because of the serious prejudice that would inure to the Trustees if such new issues were injected into the proceeding. An examination of the authorities,*

* We will not, of course, discuss the California authorities which support the California Court's decision to reject Esgro's proposed amended pleading in the California Proceeding. Esgro does not even mention in its brief its attempt to file the amended pleading in California. However, we cannot help but comment upon the peculiarity of the position taken by Esgro on this appeal.

Esgro fought long and hard to have the merits of its claims adjudicated in the California Courts. Indeed, it continues to take the position in its brief that all issues "as to the nature of the claims" should be left to the "trial Court in California" (see Esgro's Brief, p. 5) -- ignoring the fact that this is precisely what happened. Indeed, Esgro's present appeal makes sense only if it is construed as an attempt by Esgro--having lost on all facets of its claims in California--to now litigate the issues contained in the amended proof of claim in the Bankruptcy Court.

discussed in detail below, demonstrates, we respectfully suggest, that Judge Gagliardi was perfectly justified and did not abuse his discretion in dismissing Esgro's amended proof of claim filed, as it was, on the eve of trial.

The Amended Proof of Claim Presented An Entirely New Claim

While, as is pointed out at page 19 of Esgro's brief, courts have recognized that, as a rule, leave to amend a claim should be granted where a proposed amendment merely particularized prior allegations, see, e.g., In re Ebeling, 123 F. 2d 520, 521 (7th Cir. 1941), this general rule does not extend to the situation where a claim seeks to introduce a distinctly new and different claim. In the litigation surrounding the bankruptcy of the G.L. Miller & Company, this Court set forth some oft-cited rules about the introduction of new claims:

> "It is urged by appellant that the trend of modern decisions is to allow great liberality in the amendment of claims in bankruptcy. So it is; but it is to be noted that the authorities cited as indicating this liberal tendency deal with situations which fall short of that here presented. They permit amendments to correct defects of form, or to supply greater par-

> ticularity in the allegations of fact from which the claim arises, or to make a formal proof of claim based upon facts which, within the statutory period, had already been brought to the notice of the trustee by some informal writing or some pleading in the bankruptcy proceedings. See Globe Indemnity Co. v. Keeble, 20 F.(2d) 84 (C.C.A.4); In re Fant, 21 F. (2d) 182 (D.C.W.D.S.C.); In re Atlantic Gulf & Pac. S.S. Corp., 26 F.(2d) 751 (D.C. Md.); In re Kardos, 17 F.(2d) 706, 708 (C.C.A. 2); In re Kessler, 184 F.51 (C.C.A. 2); Scottsville Nat. Bank v. Gilmer, 37 F.(2d) 227 (C.C.A. 4). It is quite another matter to use an 'amendment' as a device for filing after the statutory period a claim based upon a cause of action of which no notice whatever had been given the trustee by anything previously filed." In Re G.L. Miller & Co., 45 F. 2d 115, 116 (2d Cir. 1930)

The Court concluded the claimant had originally contended that certain sums of money were received by the bankrupt either for the claimant's use or that it was held by persons to whose rights the claimant had been subrogated. The proposed amendment alleged that the obligations arose out of an express agreement to indemnify. The Court affirmed the denial of leave to amend noting that:

> "the right to amend can go no further than to permit the bringing forward and making effective of that which in some shape was asserted in the original claim ....In the case at bar we find nothing

> in the original claim to serve as the basis for the proposed amendment. No facts were alleged and no indebtedness asserted which would give the trustee in bankruptcy notice of the existence of any indemnity obligation, either by law or by express agreement, consequently the proposed amendment was properly refused." 45 F. 2d at 116-117.

See also Continental Motors Corp. v. Morris, 169 F. 2d 315 (10th Cir. 1948), where the Court, although it permitted a claimant to amend his claim for damages resulting from breach of contract, noted:

> "After the time for filing of claims has passed only such amendments may be made as do not change or alter the ground for recovery set out in the original claim ...." 169 F. 2d at 317.

Under the above discussed standards, it is clear that the proposed amended proof of claim both alters the grounds for recovery and states an entirely new claim premised upon an entirely new theory of liability. Not only does the amended claim add totally new allegations to the effect that White Front made false representations as to its own financial condition and profitability (A 23), but it also abandons the central basis of its earlier claim,

i.e., that White Front had decided by December of 1970 to close all or substantially all of its stores (A 5-6).

Esgro attempts to minimize the impact of its Amended Proof of Claim by referring to it as an "updating" or "particularization" of the original Proof of Claim (Esgro Brief, pp. 11, 22). It is, we respectfully suggest, clear that even a cursory analysis demonstrates that this is not the case. The only "representation" referred to in the original Proof of Claim was the alleged representation that White Front stores "would remain open through the entire term of the said agreement, as amended, and further that additional White Front stores would be opened" and that the "White Front Stores would continue operations and that there had been no resolution or determination made that any of the said White Front Stores would be closed" (A 6). Thus, the gravamen of Esgro's "fraud" claim, as contained in the original Proof of Claim, was that these representations were false in view of White Front's alleged determination "prior to December of 1970...to either sell or close all or substantially all of said White Front Stores" (A 5).

In its Amended Proof of Claim (A 21-29), Esgro completely changed its theory of liability. No longer

was there an allegation that a determination was made in December of 1970 concerning the closing of White Front stores. Rather, it was alleged that during the course of negotiating the December 1, 1970 agreement, White Front made misrepresentations to Esgro concerning the financial condition and profitability of White Front and Interstate, White Front's parent corporation (A 22-23). The fact that White Front had lost money in 1970 was not disputed. Although the financial condition of White Front and Interstate could conceivably be deemed relevant on the question of an alleged intention to close stores in 1970, nothing in the original Proof of Claim brought into issue the questions of what was said during the negotiations of the December 1970 agreement concerning White Front and Interstate's financial condition, the materiality of any such statements and Esgro's alleged reliance thereon on the justifiability of his reliance thereafter. Indeed, the agreement contained no representations and warranties concerning the financial condition of either party.

In determining whether a different cause of action is stated, the following test has been applied in the context of Rule 15 of the Federal Rules of Civil Procedure:

> "A fair test in determining whether an amended pleading introduces a new cause of action is whether evidence tending to support the facts alleged could have been introduced under the former pleadings." Wisbey v. American Community Stores Corp., 288 F. Supp. 728, 732 (D. Neb. 1968) (citations omitted).

Clearly, the evidence supportive of claimant's amended proof of claim would not be relevant or material to its prior claim.

The amended proof of claim essentially alleges that, White Front made certain misrepresentations concerning, or failed to disclose, the financial condition of White Front and Interstate during the 1970 negotiations; thereby raising totally different issues from those central to its earlier claim; i.e., an intent to close stores. The resolution of factual questions which previously held no significance, such as the accuracy of debtor Interstate's financial statements, as well as the existence and character of related oral representations allegedly made in 1970, becomes crucial. Thus, the amended proof of claim injects totally new issues, the presentation as well as the defense of which all depend upon completely new facts, none of which were either explored or developed in the course of discovery. New questions of law are also injected into the proceeding, including, the nature of the relationship between White Front and Esgro and what

duty, if any, White Front had to disclose certain facts to Esgro, whether misrepresentations were made, whether the alleged misrepresentations were material and whether Esgro's alleged reliance was justified. Furthermore, by concealing its intention to assert this totally new claim until important discovery had been concluded (A 53-54, A 154-155), Esgro effectively precluded the Trustees from having discovery of these issues.

Under the allegations of the amended proof of claim, the negotiations leading to the December 1970 agreement would have taken on a completely different light. Although the financial condition of White Front in 1970 could, as found by the California Court (see SA 54) be cited as some evidence that White Front had in 1970 decided to close a substantial number of stores--in support of the allegations contained in the original proof of claim--no question was raised by the original proof of claim concerning the accuracy of Interstate's financial statements or any representations made in the course of negotiations concerning White Front's financial condition.

In short, the proof required to make out and rebut the allegations of the amended proof of claim is totally different than the proof required to make out

or rebut the allegations contained in the original proof of claim. In this light, the requirements enunciated in Rule 9 of the Federal Rules of Civil Procedure that fraud or mistake be pleaded with particularity are, therefore, understandable. Rule 709 of the Bankruptcy Rules makes that rule applicable to "adversary proceedings". Although the matter before the District Court was technically a "contested matter", the import of alleging fraud with particularity remains.

The prohibition against asserting an entirely new claim by amendment is frequently expressed in terms of a requirement that the original claim must have given some notice of the issues sought to be presented on amendment. For example, in In re Starks, 55 F. Supp. 66 (E.D. Pa. 1944), a bank had first claimed over $62,000 based on monies loaned or advanced to the bankrupt, its agent. When the trustee and other creditors objected to the inclusion of approximately $27,000 on the grounds that that much of the claim represented the value of pledged jewelry the bank had entrusted to its now bankrupt agent, the bank sought to file an amended proof of claim premised on conversion by the bankrupt. The court concluded that even though the bank, the trustee and other creditors may have known of the existence of this amended cause of action; no preamendment asser-

tion of the new claim was made, nor was there any evident intention to assert this claim. Quoting this Court's decision in In re G.L. Miller, supra, the court observed that allowing an amendment would be inappropriate since:

> "It is quite another matter to use an 'amendment' as a device for filing after the statutory period a claim based upon a cause of action of which no notice whatever had been given the trustee by anything previously filed." 55 F. Supp. at 69.

Similarly, in Tarbell v. Crex, 90 F. 2d 683 (8th Cir. 1937), the Court concluded that the informal claim filed was totally deficient in alleging the requisite facts. Consequently, no amendment could be allowed since:

> "No facts were alleged and no indebtedness asserted which would give the trustee in bankruptcy notice of the existence of any indemnity obligation, either by law or by express agreement." 90 F. 2d at 685.

The only allegations as to alleged misrepresentations contained in the original proof of claim were that White Front/Interstate had "affirmatively represented to and assured Esgro that such stores [it allegedly intended to close] would remain open through the entire term" of the agreement (A 5). The Trustees were given no notice

thereby of the new ground of liability asserted in the amended proof of claim, i.e., misrepresentations concerning the financial strength of both White Front and Interstate from December 1970 to November 1972. Esgro's intention to amend its claim in this regard was not communicated to the Trustees until August of 1976 (A 53-54). Indeed, Esgro concealed its intention to attempt to amend its claim from the Trustees until after important discovery had been concluded (A 52-53).

The Finding of Prejudice to the Trustees is Fully Supported by the Record

Clearly, it is within the District Court's discretion to decide whether or not leave to amend should be granted (3 Collier on Bankruptcy, § 57.11 at 217 (1976)). One of the crucial factors looked to in exercising this discretion is the detriment that will be incurred by the other party if amendment is allowed. In Chassen v. United States, 207 F. 2d 83 (2d Cir. 1953), cert. denied, 346 U.S. 923 (1954), the Court allowed the government to amend its proof of claim for taxes owing since "no one changed his position in reliance on the previous failure to state the facts." See also Rumsey Manufacturing Corp. v. United States, 206 F. 2d 565 (2d Cir. 1953).

Esgro argues that the Trustees have suffered no prejudice by reason of Esgro's delay in filing its Amended Proof of Claim and chides Judge Gagliardi for not setting forth any "plausible basis" in support of his finding of prejudice (Esgro Brief, p. 5). In addition to assuming that Judge Gagliardi was required to set forth the basis for his finding, in view of the overwhelming evidence of prejudice set forth in the Trustees' moving papers (A 49-56, A 152-157), this argument ignores the fact that the California Court reached precisely the same conclusion in refusing to permit Esgro to amend any pleadings in the California Proceedings.

It is clear that the Trustees justifiably relied, to their prejudice, on Esgro's original characterization of its claim. The proposed amendment which, in addition to asserting entirely new allegations of wrongdoing and increasing the amount claimed by $5,000,000, was not served until November 1, 1976, approximately two weeks prior to the date set for trial. It is, however, clear that Esgro knew all of the facts upon which its new claim is based long before it filed its amended claim (A 51-53). The operating statements, which clearly showed the large White Front loss in 1970, were produced in early

July of 1976.* Yet, Esgro gave no indication of any intention to seek leave to amend until after the Trustees had completed crucial depositions in late July** (A 53, A 154). This was in late July 1976. In the intervening three months between July and November, Esgro took no action to bring such amendments before the Court, despite its knowledge that the Trustees would object to any such amendment (A 53-54).

Esgro's argument, at page 26 of its brief, that it did not believe that it had to amend its claim because it was inserting the allegations subsequently contained in the amended Proof of Claim in the "contentions" section of the pre-trial

---

* In addition, the moving papers made it clear that Esgro knew of this loss long before it received copies of the operating statements (A 51-53).

** As it argued in its papers submitted to Judge Gagliardi (A 100), Esgro now states, in its brief (p. 10), that the depositions took place "within several days following the production of the aforesaid operating statements." It is undisputed, however, that three full weeks elapsed between the document production and the depositions (A 152). Esgro obviously knew during the course of the depositions that it was going to take this position. Yet, at no time during the course of the depositions of either Francis J. Esgro, Esgro's president, or Harry Epstein, the person who negotiated the agreement in question on White Front's behalf, did Esgro's counsel indicate that it would attempt to rely upon such alleged representations (A 53, A 154-155). It was not until immediately following the conclusion of the Epstein deposition--after Epstein had been excused--that Esgro's counsel mentioned in passing that it might rely upon alleged representations concerning White Front's financial condition in 1970.

order, cannot be taken seriously. The pre-trial order's "contentions" section also included the Trustees' contention that Esgro had no right to offer evidence at the trial in support of these contentions since they were not within the scope of the original Proof of Claim.

Similarly wanting is Esgro's argument (at page 27 of its brief) that the Trustees were free to take any additional discovery on Esgro's new claims at any time. Apparently, it is Esgro's position that the Trustees were obligated to take discovery in anticipation of Esgro's Amended Proof of Claim before even knowing the precise allegations of wrongdoing being charged and before knowing for sure that such allegations would actually be made. Merely stating the argument, we respectfully suggest, demonstrates its absurdity.*

* At page 27 of its brief, Esgro refers to the suggestions made by a Commissioner of the California Superior Court, during the course of a settlement conference, that Mr. Esgro's deposition be continued that day. The Trustees' counsel declined to resume the deposition because he had travelled to California for the sole purpose of attending the settlement conference and did not have any papers or documents with him (A 156-157). In addition, such a deposition would have been in violation of Judge Cannella's September 1, 1976 order and Esgro's own counsel did not even agree that it would be appropriate for Mr. Esgro to be examined on such short notice (A 157).

Esgro also contends, at page 24 of its brief, that the new issues presented by the Amended Proof of Claim were interjected into the case by the Trustees themselves. Esgro argues that since the Trustees filed a complaint in the Bankruptcy Court against Esgro on October 22, 1976, Esgro necessarily answered the complaint and incorporated the allegations of the then recently filed, but not yet dismissed, Amended Proof of Claim as an affirmative defense. Although never stated in so many words, Esgro apparently believes that this incorporation in the answer precluded the dismissal of the Amended Proof of Claim. This argument is completely devoid of merit for any one of several reasons.

First, contrary to Esgro's assertion at page 24 of its brief that the Trustees "sought and obtained leave" to file the complaint, it was served in response to Judge Cannella's direction at the October 18 pre-trial conference that all issues between Esgro and the debtors relating to the Residential Interior Departments be tried before him. This included the claims of White Front which had been asserted in the complaint in the California Proceedings.*

* The Trustees up to that time had been perfectly content to have their claims against Esgro decided by the California Court. It was only Esgro's claim, which was holding up the reorganization proceeding, that the Trustees were seeking to have tried expeditiously before the Bankruptcy Court.

The complaint filed on October 22, 1976 did nothing more than reassert those same claims, adding amounts which became due subsequent to the time the California complaint had been served. It was denominated a complaint only because of the special requirements of the bankruptcy rules (see, e.g., Bankruptcy Rules 306(c) and 701). It was, in reality, a counterclaim against Esgro.

Moreover, even if the issues presented in Esgro's Amended Proof of Claim were "interjected" by reason of the October 22, 1976 complaint, that complaint, for all practical purposes, is no longer before the Bankruptcy Court in that all issues presented therein have now been tried as part of the California Proceedings. Therefore, even if the allegations of the Amended Proof of Claim are still technically before the Bankruptcy Court by reason of the affirmative defenses in Esgro's answer, this is of no significance.

In making its argument in this regard, Esgro continues to close its eyes to everything that has taken place in this matter subsequent to this Court's November 23, 1976 order. Esgro gives no indication as to what it thinks should be done even if this Court reverses the order appealed from.

Apparently, it is Esgro's contention that (a) its Amended Proof of Claim should be permitted to stand even though the California Court--where this Court sent the parties for the adjudication of their disputes--rejected precisely the same pleading and (b) that Esgro should then be permitted to have its Amended Proof of Claim tried in the Bankruptcy Court even though it fought long and hard--and successfully--to have its claims against the Trustees decided by a California jury. We respectfully suggest that Esgro has had its day in court and lost and that its attempt to have a second chance to prove its claim should be rejected out of hand.

CONCLUSION

For all of the foregoing reasons, we respectfully submit that the order appealed from should be affirmed.

Respectfully submitted,

SHEA GOULD CLIMENKO & CASEY
Attorneys for Appellees
330 Madison Avenue
New York, New York 10017
(212) 661-3200

Of Counsel:

Martin I. Shelton
Daniel L. Carroll

Two (2)

7th March 1977

Lawrence Altman for Weil, Gotshal & Manges,
Attorneys for California Wholesale Electric Company

3/7/77 @ 2:55 PM Jean Glenn for Jack Log Host
Attorneys for Institutional Creditors

Counsel SEC